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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)))	MM Docket No. 93-215
Rate Regulation	))	

COMMENTS OF TIME WARNER ENTERTAINMENT COMPANY, L.P.

Willkie Farr & Gallagher
Three Lafayette Centre
1155 21st Street, N.W.
Suite 600
Washington, D.C. 20036-3384

Its Attorneys

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SUMMARY

TWE files these comments in response to the Further Notice of Proposed Rulemaking in the cost-of-service proceeding. Far from a last-resort, backstop measure for governing the reasonableness of regulated cable services, the Commission proposes to replicate, in contravention of the Cable Act, most of the Title II devices used to regulate telcos.

The proposal to adopt the interim cost-of-service rules as a permanent alternative scheme of regulating cable services rates is unlawful and unsound. The Commission's cost-of-service regime ignores the congressional mandate against common carrier regulation and administrative complexity. The plain language of the statute expressly forbade the application of traditional common carrier principles as a method for regulating the rates of cable systems.

Likewise, the Commission's objective to establish regulatory parity with telcos is an unlawful and inappropriate policy objective. Regulatory parity is inconsistent with Congress' mandate not to regulate cable under a common carrier scheme. It is also a wholly inappropriate policy objective given that cable systems vary markedly from another and provide distinct services. Moreover, the dramatic differences between cable and telephone companies render any type of comparison between the two meaningless.

In implementing the cost-of-service rules, TWE requests that the Commission allow cable companies to readily switch

between cost-of-service and benchmark elections. Such flexibility is necessary in order to permit the most efficient pricing by cable companies.

TWE also urges the Commission not to apply the proposed cost-of-service rules to cable operators under benchmark regulation. Specifically, TWE objects to requiring benchmark regulated cable systems to comply with cost allocation, uniform accounting, and affiliate transaction rules, as well as a productivity offset.

For cable operators seeking external cost adjustments, the application of the cost allocation rules will raise considerable ambiguity and potentially impose substantial burdens on cable operators. Instead, the Commission should clarify that all external costs are to be directly assigned and otherwise abandon cost allocation rules beyond the requirements of GAAP. Further, the Commission cannot lawfully require the separate reporting of unregulated activities as it proposes to do. Once costs are found to be nonjurisdictional, the Commission's authority to track such costs is extremely limited.

Moreover, the Commission should not impose a uniform accounting system for cable operators electing cost-of-service or benchmark regulation. Furthermore, use of a uniform system of accounts based on the telco model is inappropriate. The telco accounts are not transferrable to cable. Simply adding accounts specific to cable will not correct the overall problem with using a telco-based system for cable.

Similarly, the proposed affiliate transaction rules applicable to cable operators who either elect cost-of-service regulation or seek to adjust benchmark/price cap rates for affiliated programming costs unnecessarily limit the use of prevailing company pricing. Unlike transactions between telcos and their affiliates, transactions in the cable industry take place free of regulatory distortions. Further, because such transactions primarily involve the purchase of programming from affiliated programmers who sell the same products to third parties, the use of prevailing company pricing is a reasonable, reliable measure of fair market value for the vast majority of transactions that occur between cable affiliates.

TWE also urges the Commission not to apply a productivity offset to cable as a part of the "price cap" adjustment. The Commission's proposal to adopt a 2% productivity offset is nothing more than an opinion expressed by one party in this proceeding. Unlike the record in the telco price cap proceeding, there is no record evidence here to support a cable productivity offset. Moreover, as explained in the attached paper by Daniel Kelley and Robert Mercer of Hatfield Associates, Inc., the factors justifying an offset in telephony are not present in the cable industry. Technological differences as well as the constant state of technological change in the cable industry makes it difficult, if not impossible, to determine with any confidence future productivity trends.

Finally, TWE urges the Commission to implement its Upgrade Incentive Plan and abbreviated cost-of-service showings for network upgrades on a case-by-case basis. In implementing these programs, the Commission needs to provide more specific inducements to the cable industry in order to allow these alternatives to work. It should eschew industry-wide rules and deliberately allow cable companies the flexibility to proceed on a case-by-case basis. Moreover, in order to achieve national policy goals, especially the development of the National Information Infrastructure, the role of franchising authorities must necessarily be limited to that of implementation.

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Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)))	MM Docket No. 93-215
Rate Regulation	))	

COMMENTS OF TIME WARNER ENTERTAINMENT COMPANY, L.P.

Time Warner Entertainment Company, L.P. (TWE), by its attorneys, files these comments in response to the Further Notice of Proposed Rulemaking in the above-captioned docket which proposes to establish certain cost-of-service rules to govern the reasonableness of rates for cable companies electing either the benchmark formula or cost-of-service proceedings. For the reasons stated below, TWE opposes the adoption of the proposals set forth in the Further Notice.

I. INTRODUCTION

The Further Notice contains two general sets of proposals: (1) the adoption of the interim cost-of-service rules as a permanent set of rules governing cost-of-service showings by cable operators; and (2) the application of certain aspects of these rules to all regulated cable systems, including those electing benchmark regulation. In both cases, the proposed rules are directly taken from the FCC's regulatory experience with telephone companies; that is, they are rate-of-return regulatory mechanisms in the classic sense.

The legal and policy constraints upon the FCC's use of rate-of-return regulation for cable rates are substantial and explicit. Nevertheless, they have been utterly ignored in this proceeding. The Commission is proposing to establish a scheme that would apply traditional Title II mechanisms to both cable firms electing cost-based showings and firms utilizing benchmarks that seek to modify their rates on a going-forward basis. Notwithstanding its claim that it has streamlined Title II for purposes of regulating cable,[1] the FCC has done little more than adopt it wholesale. Far from being a last resort, backstop measure for governing the reasonableness of regulated cable services, cost-of-service regulation in the classic public utility mode has tainted all aspects of the FCC's implementation of the 1992 Cable Act. The replication of Title II devices reflected in the proposed rules governing cost-of-service proceedings, as well as their use for benchmark-regulated firms,

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[1] Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation and Adoption of a Uniform Accounting System for Provision of Regulated Cable Service, MM Docket No. 93-215 and CS Docket No. 94-28, Report and Order and Further Notice of Proposed Rulemaking at para. 25, FCC 94-39 (released March 30, 1994) (Cost-of-Service Order or Further Notice).

This pleading is submitted without prejudice to TWE's claims and arguments in its pending challenges to various provisions of the Cable Act. See e.g., Time Warner Entertainment Company, L.P. v. FCC, Civ. Action No. 92-2494 (D.C. Cir. filed Nov. 15, 1992); Time Warner Entertainment Company, L.P. v. FCC, Civ. Action No. 94-1438 (D.C. Cir. filed June 13, 1994).

is in direct contravention of the Cable Act and must be remedied in this proceeding.

TWE's current intentions are to utilize benchmarks to establish the reasonableness of rates charged by its cable systems. It will therefore not discuss in detail the various intricacies set forth in the interim rules now proposed to be permanently adopted. TWE nonetheless briefly details the bases for its belief that these rules are directly contrary to the twin legislative commands to the FCC in assessing cable rates: (1) the prohibition on the use of traditional public utility ratemaking mechanisms; and (2) the avoidance of administratively burdensome procedures.

The remaining focus of these comments rests on the set of rules proposed to apply to cable operators seeking to use benchmarks, and the price cap formula to adjust rates in the future. These rules, specifically, cost allocation, uniform accounting, affiliate transaction, and productivity offset, utterly sabotage any of the ostensible benefits of implementing the benchmark scheme. The negative policy implications of the proposals, especially those for productivity offsets, are further explicated in a paper prepared by Daniel Kelly and Robert Mercer of Hatfield Associates, Inc., submitted with these comments.[2] Proposed at least in part out of the misguided and illegal objective of creating regulatory parity between cable companies

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[2] Daniel Kelley and Robert Mercer, Hatfield Associates, [redacted]

and telephone companies, the proposals infest the primary means of regulating cable rates with traditional common carrier methods and burdens in direct contravention of the Cable Act. These proposals should be scrapped.

II. PERMANENT RULES CANNOT BE ADOPTED AS A MATTER OF LAW OR POLICY.

The proposal to adopt the interim cost-of-service rules as a permanent alternative scheme of regulating cable services rates is unlawful and unsound. These rules are rife with errors and misjudgments. Most fundamentally, they represent an effort to burden the cable industry -- and ultimately, the consumers of cable services -- with common carrier regulation and all of the distortions that inhere. Congress expressly forbade the Commission to take this ill-advised course.

A. The Commission's Cost-of-Service Regime Ignores the Congressional Mandate Against Common Carrier Regulation and Administrative Complexity.

Congress expressly forbade the application of traditional common carrier principles as a method for regulating the rates of cable systems. Congress could not have been clearer in forbidding this result. Section 621(c) of the Cable Act states that:

> Any cable system shall not be subject to regulation as a common carrier or utility by reason of providing any cable service.

47 U.S.C. § 541(c).[3]

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[3] The legislative history underscores this proscription. For example, the House Report provides:

(continued...)

Traditional rate-of-return regulation has been

described briefly

as a series of mechanical steps. The regulator, in determining prices, proceeds as follows:

1. He selects a test year for the firm.

2. He adds together that year's operating costs, depreciation, and taxes.

3. He adds to that sum a reasonable profit, determined by multiplying a reasonable rate of return times a rate base, which is determined by taking total historical investment and subtracting total prior depreciation.

4. The total so far equals the firm's revenue requirement. The regulator now sets prices so that the firm's gross revenues will equal its revenue requirement.

5. If the firm provides several different classes of service or serves different classes of customers, the regulator may also determine the percentage each will contribute to the total revenue, in effect determining the firm's "rate structure.[4]

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[3](...continued)

The Committee is concerned that several of the terms used in this section are similar to those used in the regulation of telephone common carriers. It is not the Committee's intention to replicate Title II regulation.

* * *

The Committee does not intend for the Commission, in determining the reasonable profit allowed cable operators, to create a traditional "rate of return" comparable to that permitted telephone common carriers.

H.Rep. No. 102-628, 102d Cong., 2d Sess. at 83 (1992).

[4] S. Breyer, Regulation and Its Reform at 36 (1982).

This description could readily serve as an executive summary of the instant proceeding and the concomitant creation of Form 1220.[5] No relabeling, no matter how creative, can disguise away the reality of the proposed rules: they constitute traditional public utility ratemaking in direct contravention of Congress' mandate.

The proposed rules are equally at odds with the legislative command for an administratively simple regulatory scheme. The Commission has been expressly directed, in prescribing rate regulations for the basic cable tier, "to seek to reduce the administrative burdens on subscribers, cable operators, franchising authorities, and the Commission."[6] "Expeditious procedures" are similarly required for the regulation of unreasonable upper tier rates.[7] Cost-of-service regulation is the antithesis of simplicity and expedition.[8] The

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[5] Even the price changing mechanisms are derived from public utility traditions. Although "tariffs" are not literally required, new rates must be proposed in filings with regulators, placed on public notice, may be suspended and investigated, and, after hearing, prescribed.

[6] 47 U.S.C. § 543(b)(2)(A).

[7] Id. at § 543(c)(1)(B).

[8] The legislative history again underscores the plain language of the statute:

> The Committee intends that the Commission establish a formula that is not cumbersome for the cable operator to implement nor for the relevant authorities to enforce. The Committee is concerned that several of the terms used in this section are similar to those used in the regulation of telephone

(continued...)

Further Notice cannot be reconciled with the legislative requirements, especially in light of the numerous alternatives in the record that would far more faithfully adhere to rules of administrative simplicity.[9]

The Cost-of-Service Order concedes that the new rules are formulated upon the traditional public utility model, but attempts to justify those rules by characterizing them as a "streamlined" version of Title II, "requiring less detail[]" and "imposing no annual or biannual filing requirements."[10] The reality of the Order belies these statements. The fact that a form has been created for cost showings hardly equates to streamlining. Indeed, the current form has created more questions and burdens than a carrier-initiated rate proceeding

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[8](...continued)

> common carriers. It is not this Committee's intention to replicate Title II regulation. The FCC should create a formula that is uncomplicated to implement, administer, and enforce, and should avoid creating the cable equivalent of a common carrier "cost allocation manual."

H. Rep. No. 628, supra, at 83.

[9] See, e.g., Comments of TWE in MM Docket No. 93-215 (filed August 25, 1993).

[10] Cost-of-Service Order at para. 25. The Commission also attempts to justify the use of rate-of-return ratemaking by noting that its "primary benchmark/price cap approach does not impose the tariff filing, accounting, and cost support obligations" of Title II. Id. at para. 9. This statement is incorrect, for it ignores the use of the cost accounting and cost allocation requirements that attach to benchmark-electing operators who seek forward adjustments on the basis of exogenous costs. In any event, Congress forbade the use of these conventions altogether. Section 621(c) contains no exception for secondary methods of regulating cable rates.

would likely require.[11] With respect to the level of detail required, the Commission's implementation of its lawful Title II obligations has been far less onerous on regulated firms. And as for annual and biannual filings, the statement is true only because the cable rate scheme requires quarterly filings of cable operators for price cap adjustments.[12]

The FCC's failure to recognize the exceptionally limited role that costs may play, i.e., as a "safety net" rather than a full regulatory alternative, has created a regulatory scheme which exceeds the Commission's jurisdiction. It also has led to several other fundamental errors. First, it has led to the adoption of an ill-considered, unjustified, draconian benchmark formula, apparently under some contrived logic that shooting wide of a legitimate mark is acceptable because there exists a cost-of-service option. The fundamental problem here is that the formula yields permissible rates which are so low that it is likely to induce cost-of-service elections far more broadly than the exceptional case.

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[11] The Commission has rarely undertaken a full cost-of-service review of all regulated service offerings of a carrier; however, in the rare instance one has been initiated by the agency, it has taken years to complete. American Telegraph and Telephone Co., Docket 19129, 27 FCC 2d 149 (1971); 27 FCC 2d 151 (1971); 38 FCC 2d 213 (1972); 38 FCC 2d 269 (1972); Phase II Final Decision and Order, 64 FCC 2d 1 (1977); recon., 67 FCC 2d 1429 (1978).

[12] The filings are "optional" only in the sense that cable operators can forgo the recovery of exogenous cost increases, a circumstance that can best be described as a Hobson's choice. The quarterly filing is in any event mandatory for cable operators experiencing exogenous rate decreases.

Second, and more specific to this proceeding, the failure to consider the especially narrow utility of cost analysis has also resulted in rule proposals that would incorporate cost-based regulation to benchmark-electing cable operators. In particular, the proposals to extend Uniform System of Account ("USOA") requirements and affiliate transaction rules, as more fully discussed below, bring all regulated cable operators under the traditions and inefficiencies of public utility regulation.

Third, the application of a backward, inefficient, and universally criticized system of regulation to a high-growth industry is itself inexplicable.[13] The Commission has done everything within its powers to abandon cost-of-service regulation for telephone companies out of express recognition of

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[13] The Commission is all too aware of the problems with traditional rate-of-return regulation. Such a scheme not only creates disincentives for firms to act efficiently, but cost-of-service regulation is inherently complex, costly, and time-consuming to implement. Even when supposedly serving solely as a secondary method of regulation, rate-of-return regulation is inappropriate as a policy matter and inconsistent with the stated purpose of the Cable Act.

Over the course of the past few decades, there has been considerable study and debate on whether traditional cost-of-service principles effectively replicate marketplace incentives. The overwhelming conclusion reached by noted economists and scholars is that it does not. Indeed, cost-of-service regulation produces the very opposite result: it creates disincentives for firms to act in economically efficient ways. Substantial resources have been spent over the years trying to overcome these inefficiencies as regulators have become more aware of the problems associated with traditional rate-of-return regulation.

its perverse costs, yet it has embraced it here with no explanation and no sense of historic lessons.[14]

Fourth, as discussed above, the Commission's interim cost-of-service rules establish an elaborate and far-reaching scheme of regulation that unduly burdens cable operators, local franchising authorities, and FCC resources, again in contravention of the Cable Act.[15]

Finally, the proposal to permanently adopt the interim rules is totally at odds with Congress' intention that cable rate regulation be implemented on a transitional basis, i.e., until "effective competition" is established. The elaborate cost-of-service rules, imposing dramatic and costly changes in accounting and financial practices, appears premised on the notion that such administrative costs are justified because they somehow reflect the new status quo for the long haul. Outside of the formal orders, the Commission has protested that the agency's efforts will be directed at facilitating competitive methods of video distribution as the only efficient means of truly ensuring

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[14] It is, of course, ironic that the Commission proposes to adopt a permanent regulatory regime for cable based on a model it has declared unsuitable. See, e.g., Policy and Rules Concerning Rates for Dominant Carriers, 4 FCC Rcd 2873 (1989) (AT&T Price Cap Order); 5 FCC Rcd 6786 (1990) and Erratum, 5 FCC Rcd 7664 (1990) (LEC Price Cap Order).

[15] 47 U.S.C. § 543(b)(2)(A).

reasonable cable rates.[16] That message has yet to be reflected in the rate regulations, however.

B. Regulatory Parity With Telcos is an Unlawful and Inappropriate Policy Objective.

One of the most glaring errors in the Commission's stated objectives is that of attaining regulatory parity between the telephone and cable industries.[17] Regulatory parity with telcos, however, is inconsistent with Congress' mandate not to regulate cable under a common carrier scheme. Moreover, it is a wholly inappropriate policy objective in this context.

Regulatory parity is an appropriate objective where similarly situated companies seek to compete to provide the same services. It is wholly inappropriate where companies vary markedly, as the Commission's policies have long since established.[18] It is equally inappropriate where companies provide distinct services which are not adequate substitutes for one another. There are, in fact, dramatically distinct differences between cable companies and telephone companies. The services to be regulated in this proceeding are not those provided by telephone companies. Telephony is an essential

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[16] See, e.g., Chairman Reed E. Hundt Speech Before the 43rd Annual Convention & Exposition of the National Cable Television Association in New Orleans, Louisiana, 1994 FCC LEXIS 2310, May 24, 1994.

[17] Cost-of-Service Order at para. 26.

[18] See, e.g., Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, CC Docket No. 79-252, First Report and Order, 85 FCC 2d 1 (1980) (establishing classification of carriers as either dominant or nondominant).

service -- a critical part of the nation's economic infrastructure used to provide virtually every service and product in the economy. Cable television, in marked contrast, is an elective service that more than 40% of Americans choose not to buy. More importantly, regulation of pure transmission services has only marginal First Amendment significance. By contrast, regulation of cable as a First Amendment speaker constitutes infringement upon fundamental constitutional rights.[19]

An unintended consequence of public utility regulation is to alter -- perhaps reduce -- the quality of programming provided to consumers. Such effects not only undermine the Commission's goals of encouraging high quality and diverse programming sources, but have constitutional implications as well.[20] Economic regulation affecting and impairing programming is something which the FCC appropriately recognizes as a dangerous consequence of cable regulation[21] -- but it is a consequence that in fact has not been avoided in the Commission's implementation of the Cable Act. Numerous aspects of the rate scheme -- including the productivity offset proposal, the affiliate transaction proposal and the going-forward methodology

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[19] See Turner Broadcasting System, Inc. v. FCC, 62 U.S.L.W. 4647 (U.S. June 27, 1994) (No. 93-44); FCC v. Midwest Video Corp., 440 U.S. 689, 709 n.19 (1979).

[20] See Riley v. National Federation of the Blind, 487 U.S. 781, 789 n.5 (1988).

[21] Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, MM Docket No. 92-266, Report and Order and Further Notice of Proposed Rulemaking, 8 FCC Rcd 5631, 5787 (1993).

rules now under further proposed changes --will effect cable operators' willingness to invest in quality programming.

Further, telephone and cable companies sit in very different positions with respect to their historical regulation. The telephone industry has been under the umbrella of public utility regulation for nearly 100 years -- with all of the inefficient consequences that such status implies. Price cap regulation commenced by the Commission in the late 1980's represented a deliberate step to begin to minimize these inefficiencies. More particularly, productivity offsets were used to bring the benefits of the anticipated relief in this area to consumers of telephone service.[22] But in the context of cable companies, which were never subject to such a regime, the application of productivity offsets makes no sense.

Similarly, the very different histories of these two industries lead to very different administrative costs -- private and public -- in the implementation of industry-wide regulation. The telephone industry developed as a coordinated effort by the Bell System in every significant aspect -- technical, operational, pricing, and legally. The homogeneity among telephone companies has permitted the FCC to regulate 1,100 companies with the use of broad averaging without significant costs incurred in making exceptions to account for the occasional disparity. This common history is absent among the 11,000 cable systems and 33,000 community units comprising the cable industry.

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[22] See Section V, infra.

The heterogeneity which aptly characterizes the cable industry disables the Commission and the regulated firms from capturing efficiencies in averaging or general presumptions. The Commission's efforts to nonetheless bootstrap such devices does not and cannot work. Each cost-of-service election will vary from the next and scope economies in cable regulation do not exist no matter how much the FCC might wish that they do.

In sum, regulatory parity in this context is a cynical tactic by the telephone industry to artificially burden the cable industry with regulatory mechanisms that are unjustified in the case of cable.[23] The proposals in the Further Notice which are

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[23] It is highly doubtful that parity could be achieved, even if it were sound policy. The FCC's jurisdiction to regulate varies markedly from one industry to another. Public policy for telephony is set not only by the FCC but by each of the state public utility commissions. In express departure from the Shreveport doctrine, 234 U.S. 342 (1914), Section 2(b), 47 U.S.C. § 152(b), has been construed to preclude the FCC from setting policy for intrastate services. While the FCC has sought in recent years to undo the legal stranglehold of the local telephone industry over local services, its ability to do so has been critically limited by judicial determinations that Section 2(b) reserves substantial authority to the states. In contrast, the FCC's authority to set all significant policies governing the cable industry -- both structural and behavioral -- is explicit in Title VI of the Communications Act. Many of these federal policies are established by the very terms of Title VI, for example, the proscription against exclusive franchise grants by local governments. Moreover, in other significant respects, cable companies are regulated not only at the federal and state levels but also by municipalities. Thus, the regulatory regimes for telephony and cable are distinct, and complicatedly so. A policy of regulatory parity could not succeed -- either as a matter of law or sheer practicality.

driven by this red herring cannot be sustained in law or policy.[24]

C. Cable Companies Should Be Readily Able to Switch Between Cost-of-Service and Benchmark Elections.

The Commission's Order requires that cable companies be limited to cost-of-service showings no more than every two years. What is not addressed is the flexibility to switch between benchmark and cost-of-service regulation. This flexibility for cable operators should be clearly articulated in order to permit the most efficient pricing by cable companies.

Considerable doubt looms over both the benchmark methodology and cost-of-service. Implementation questions and the need for clarification have prompted the issuance by the FCC of a steady stream of question-and-answer sheets, letter rulings, and miscellaneous interpretative orders, and these are only the beginning. Many issues will not be fleshed out until individual complaints and cost-of-service hearings are actually and finally adjudicated.

There is no particular basis upon which to assume that this initial set of difficulties and imprecision will not continue. Many issues have deliberately been left to case-by-case adjudication by many different regulatory authorities with very likely differing results. The outcomes of these proceedings

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[24] For a more extensive discussion of the misguided aspects of regulatory parity, see Daniel Kelley and Robert Mercer, Hatfield Associates, Inc., "Regulatory Parity and Public Policy," September 14, 1993 (at appendix) (submitted with Reply Comments of TWE in the first phase of this proceeding).

will become critical to a cable company's choice of cost-of-service versus benchmark regulation.

Finally, the value of cost-based regulation -- to allow high cost systems to recover costs not reflected in the broad averaging process inherent in the benchmark calculations -- would be substantially curtailed unless there is flexibility in switching elections. Confiscatory ratesetting remains confiscatory, even if it is short-lived. While the Commission has a legitimate interest in assuring that its administrative resources are not unnecessarily burdened through overactive switching between cost-of-service and benchmark methodologies, cable operators also have a vast disincentive whimsically to elect the elaborate and burdensome task of justifying their rates based upon detailed cost showings.

III. THE COST ALLOCATION/ACCOUNTING REQUIREMENTS SHOULD NOT BE IMPOSED

A. The Cost Allocation Rules Should Not be Applied to Cable Operators Seeking External Cost Adjustments.

Under the interim rules, cable operators seeking adjustments for changes in their external costs must comply with the cost allocation rules adopted in this proceeding. Because cost allocation rules raise considerable ambiguity and potentially impose substantial burdens on cable operators, the Commission should not require benchmark-regulated cable systems to comply with these requirements.

The cost allocation rules seek direct assignment of costs, and where direct assignment is not possible, require "indirect, cost-causative linkage." Absent direct or indirect allocation, a cost ratio is required to be implemented.

The import of these rules in the context of the limited category of external costs is very unclear. External costs eligible for pass-through are limited to a very narrow group of categories explicitly allowed under the rules, that is, franchise fees, state and local taxes, costs of franchise requirements (including PEG obligations), retransmission consent and copyright fees, and other programming costs. Each of these categories is subject to direct assignment to the specific tier implicated by the exogenous change. The only category of permitted external costs for which this is not so is franchise fees, and these by rule are allowed to be itemized and passed through separately. The potential application of a set of rules which calls for indirect "linkage" and/or allocation based upon cost ratios appears entirely moot and irrelevant in this context. As such, its existence creates only ambiguity, and with it the opportunity for additional controversy and expense litigating such controversies. The Commission should clarify that all external costs are to be directly assigned, and otherwise abandon cost allocation rules beyond the requirements of Generally Accepted Accounting Principles ("GAAP").

B. The Commission Cannot Lawfully Require the Separate Reporting of Unregulated Activities.

In the *Further Notice*, the Commission proposes to adopt as final the requirement that cable operators allocate costs among five service categories: (1) basic service tier activities; (2) cable programming services activities; (3) other cable programming services activities; (4) other cable activities; and (5) noncable activities. Among the activities contained in the last three categories are pay-per-channel and pay-per-program offerings, billing and collection services, studio and nonregulated equipment engineering and rental services, and sale and maintenance of nonregulated equipment. Because the Cable Act forbids the regulation of these activities, a requirement for separate reporting of these activities is unnecessary and ultra vires.

Contrary to the Commission's assertion, it is neither necessary nor lawful to allocate nonregulated costs to various nonregulated service categories in order to ensure that the "allocation of costs to regulated services is fair and reasonable in relation to the allocation of costs to nonregulated services."[25] Once costs are found to be nonjurisdictional, the Commission's legal authority to track these costs is extremely limited. The Commission's interest in ensuring the proper allocation of costs to regulated and nonregulated activities is confined to comparing nonregulated costs in toto, not its piece parts.

This view is reflected in the Commission's joint cost rules for telephony, which separate costs between regulated and nonregulated activities, but does not further disaggregate purely

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[25] See Cost-of-Service Order at para. 237.